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DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA ABAUKOL
TREASURY PASS TO FRB SAN FRANCISCO/TERESA CURRAN
STATE FOR SCA/INS AND EB/TRA JEFFREY HORWITZ AND TOM ENGLE
USDA PASS FAS/OCRA/RADLER/BEAN/CARVER/RIKER
EEB/CIP DAS GROSS, FSAEED, MSELINGER
USTR FOR CATHERINE HINCKLEY

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TAGS: EAGR EFIN EINV EPET ETRD SENV IN ECPS BEXP

SUBJECT: NEW DELHI WEEKLY ECON OFFICE HIGHLIGHTS FOR THE WEEK OF
JUNE 9 TO JUNE 13, 2008

REF A)

NEW DELHI 00001638 001.2 OF 005

¶1. (U) Below is a compilation of Economic highlights from Embassy New Delhi for the week of June 9 to June 13, 2008, including the following items:

-- RANBAXY FOUNDING FAMILY SELLS INTEREST TO DAIICHI SANKYO
-- INDIA FACES HIGHER FERTILIZER COSTS AND
   SUBSIDIES AS GOI ANNOUNCES NEW POLICY
-- INDIA'S INDUSTRIAL SECTOR REBOUNDS IN APRIL
-- SAJJAN JINDAL NEW ASSOCHAM PRESIDENT FOR 2008-09
-- U.S. COMPONENT MAKERS EYE NEW RENAULT-NISSAN PLANT
-- FERTILIZER SHORTAGES CAUSE RIOTS IN KARNATAKA
-- BUOYANT DIRECT TAX REVENUES
-- INSURANCE REGULATOR GETS A NEW CHAIRMAN
-- AIRLINE MARGINS HIT BY RISING FUEL PRICES

RANBAXY FOUNDING FAMILY SELLS INTEREST TO DAIICHI SANKYO

¶2. (U) Malvinder Mohan Singh, son of the founder of India's largest generic-drug manufacturer, Ranbaxy Ltd., and CEO of the company, this week agreed with other family members to sell their entire 34.8-percent stake in Ranbaxy. The purchaser is Daiichi Sankyo, the third-largest Japanese pharmaceutical company, which bought the shares for USD 2.23 billion. The deal is subject to regulatory approvals with anticipated completion by March 2009. Daiichi will also launch an open-market tender on the Bombay Stock Exchange to buy another 20 percent of Ranbaxy shares, thereby establishing a controlling stake in the company of 50.1 percent or more. According to press, Daiichi had been looking at opportunities to buy a generic major with R&D facilities. The Ranbaxy deal gives Daiichi access to the generics market in 60 countries, including emerging markets.

India's own pharmaceutical market is projected to expand by more than 12 percent a year in the short to medium term.

INDIA FACES HIGHER FERTILIZER COSTS AND SUBSIDIES AS GOI ANNOUNCES NEW POLICY

¶3. (U) Indian fertilizer subsidies may be the next locus for a crisis, after the recent reduction of oil subsidies in response to negative impacts on oil-marketing companies' liquidity. The fertilizer subsidy is estimated at USD 22 billion for FY 2008-09--more than double last year's USD 10 billion. Last year, however, government bonds used to pay fertilizer manufacturers covered just one fifth of the subsidy. The remainder of the subsidy was covered by direct cash payments from the government. This year, fertilizer bonds are slated to cover two thirds of the subsidy, as the government only marginally increased the cash subsidy in the budget, while fertilizer prices soared. This has prompted the Fertilizer Association of India (FAI) to write a letter to Prime Minister Singh to intervene in the matter. Industry experts opine that fertilizer bonds are an inefficient form of assistance for the industry's working-capital needs, as they are typically substantially discounted to face value when sold in the secondary market. FAI further argues that the issuance of bonds will not reduce the severity of the cash-flow problem, as suppliers of fertilizer feedstock are not keen to extend further credit to the industry on the basis of the bonds. Banks and financial institutions also do not want to extend their working-capital limit. Fertilizer manufacturers claim that selling the bonds at discounted rates will badly affect the bottom lines of the cash-strapped fertilizer units and will threaten their supply and operations. Most of the 22 fertilizer companies have incurred losses on the resale of USD 1.9 billion in bonds from last year's allocation of the instruments.

¶4. (U) Indian fertilizer companies, which must sell to farmers at government-mandated prices, are facing soaring input prices in global markets. India consumes about 48 million metric tons of fertilizers, of which 14.5 million tons are imported. While urea was priced at USD 341/ton last year in the international market, this year, its price has almost doubled to USD 625/ton. The current average landed price of di-ammonium phosphate (DAP) exceeds USD 1,300/ton, compared to USD 644/ton in 2007-08. Similar trends are evident in all other fertilizers. Claims of shortfalls in Andhra Pradesh and Maharashtra this past week are partly because of disruptions in freight movement due to ongoing Gujjar agitation in Rajasthan, but also due to fertilizer manufacturers' cutting back production in light of what they say is the government's refusal to clear last year's subsidy bill of USD 10 billion.

¶5. (U) Meanwhile, the Cabinet Committee on Economic Affairs on June 12 finally approved the much-awaited fertilizer pricing policy. The new nutrient-based subsidy policy lowers the mandated prices of more complex fertilizers to remove the price bias and overuse of urea and DAP fertilizers. The Cabinet hopes to encourage farmers to apply a more appropriate mix of fertilizers to increase yields. The prices of complex fertilizers will fall by an average of USD 33 (INR 1,416) per metric ton. Prices of other fertilizers like urea would not change. The new policy also provides for a uniform freight subsidy for all fertilizers which will help farmers to obtain fertilizers in the crucial sowing season. Analysts indicate that nutrient-based pricing is likely to increase the government's subsidy bill, primarily on account of high raw-material prices. The existing price of urea, an already heavily subsidized nitrogen input, will continue to dictate the price of nitrogen-based complex fertilizers.

INDIA'S INDUSTRIAL SECTOR REBOUNDS IN APRIL

¶6. (U) The latest economic data indicates that India's industrial growth for the month of April recovered to 7 percent, higher than the revised growth of 3.9 percent in March 2008, although lower than the 11.3-percent growth of April 2007. Mining output rose by 8.6

percent during the month, faster than the 2.6 percent of April 2007. The manufacturing ector grew by 7.5 percent in April 2008, after growing at 3.9 percent in March. This, however, is lower than the 12.4-percent growth recorded in April 2007. The capital-goods sector improved its performance and registered a healthy growth of 14.2 percent, versus 10.9 percent in April 2007. The consumer-goods sector posted a growth of 8.9 percent, recovering from a low of 0.9 percent in the previous month. However, the food-products sector registered a minus-6.3-percent growth in April 2008, compared to a high of 50.8 percent in April 2007. Electricity generation grew by just 1.4 percent, compared to 8.7 percent a year ago. Economists expect industrial growth to average in the range of 7.5 to 8 percent in FY 2008-09, as compared to 8.3 percent last year.

SAJJAN JINDAL NEW ASSOCHAM PRESIDENT FOR 2008-09

¶7. (U) Mr. Sajjan Jindal, Vice Chairman and Managing Director of Jindal South West Steel (JSW Steel), on June 3 became the President of the Associated Chambers of Commerce and Industry of India (ASSOCHAM) for the year 2008-09. Jindal started his career with the western-region operations of O. P. Jindal Group in 1983 after graduating from Bangalore University. He was the Senior Vice President of ASSOCHAM during 2007-08 and succeeds Venugopal Dhoot of the Videocon group.

U.S. COMPONENT MAKERS EYE NEW RENAULT-NISSAN PLANT

¶8. (U) On June 7, a USD 1 billion Renault-Nissan joint venture broke ground for its Chennai plant. The plant is expected to begin operations in 2010 and will have the capacity to produce 400,000 cars per year. Renault-Nissan officials told Post that the company expects to source over 70 percent of its components locally, including from the many U.S. component makers based in Chennai. The U.S. component makers are planning to expand capacity to meet increased demand when Renault-Nissan begins production. The managing director for component maker Visteon said that his company will expand operations to meet the expected growth in demand from Renault-Nissan. Radiator manufacturer Modine is planning to construct a second unit even before the company's first Chennai facility comes on line later this year.

FERTILIZER SHORTAGES CAUSE RIOTS IN KARNATAKA

¶9. (U) Fertilizer shortages led to riots in northern Karnataka. The state-run cooperative outlets that normally meet over 60 percent of the demand for fertilizer in the South Indian state found themselves short of supplies. As the monsoon set in earlier than usual, the shortages in the government cooperatives forced farmers to look to private traders, who hiked prices in response to the unusually high demand for their fertilizer. The farmers lashed out at the state government, blaming procrastination by bureaucrats for their predicament. A senior government official responsible for procuring supplies told Post that the state's recent elections were to blame. He said that he had requested funds in March 2008 but that the Governor's office, which was in control after the November 2007 imposition of President's rule in the state, was focused on the May 2008 elections.

BUOYANT DIRECT TAX REVENUES

¶10. (U) India's direct tax revenues have tripled over the last four years. The Ministry of Finance released revised figures on June 6, indicating direct tax collection reached roughly USD 79 billion (INR 3,145 billion) in FY 2007-08, up 36 percent from FY 2006-07. Of this, corporate taxes grew by 32 percent to USD 48 billion (INR 1,907 billion), while personal income tax grew by 42 percent to USD 29 billion (INR 1,142 billion). The robust revenue growth is due to high economic growth, better tax compliance by taxpayers, and improved tax administration and enforcement by the Income Tax Department. Finance Minister Chidambaram at a recent conference of

Chief Commissioners and Director Generals of Income Tax asked the Central Board of Direct Taxes (CBDT) to collect more revenues to meet the requirements of the social sector, health, and education. The budget estimate for direct tax collections for this fiscal year, previously set at the end of February at USD 86 billion (INR 3,650 billion), is likely to be revised upwards to USD 94 billion (INR 4,000 billion). Robust tax revenues may help the center and state governments to improve their fiscal situation, especially in the face of rising subsidies and recently reduced oil tariffs and excise duties.

¶11. (U) The Finance Minister also expects the number of tax returns filed to cross 35 million this fiscal year, versus 27.3 million filed in FY 2007-08. He noted that the Ministry recently instructed tax officials to prosecute those who have never filed returns or not filed for three years, if identified during search and seizure. Upon prosecution, tax evaders will have to pay a fine and, depending on the severity of the case, could also face imprisonment. The tax authorities are also concerned about non-compliance with "tax deducted at source" regulations (i.e., tax withholding at the

payroll level) by government ministries, particularly large employers Defense and Railways. The CBDT is taking steps to "sensitize" government ministries to the need to ensure payroll deductions take place.

¶12. (SBU) Comment: Chidambaram's move to increase revenues this year demonstrates how important it is to him to try to keep to the fiscal-deficit targets mandated in the Fiscal Responsibility and Budget Management (FRBM) Act. The loss of customs and excise duties as part of last week's oil price-hike package, combined with growing subsidies for oil, food, and fertilizer, and payments for the farmer debt-waiver program and the pending federal pay hike, are putting real stress on the fiscal deficit. The proposed new direct-tax revenue target of INR 4,000 billion represents a 27-percent increase over last year. Compared to the 36-percent increase in revenues from FY 2006-07 to FY 2007-08, this somewhat reflects the expected moderation in economic growth this fiscal year. However, in order to really hit the proposed revised target, the Ministry of Finance will have to improve compliance. There's plenty of room in India's generally weak tax-collection system for improvement, but much of that stems from special interests that may push back. End comment.

INSURANCE REGULATOR GETS A NEW CHAIRMAN

¶13. (U) Effective June 10, Jandhyala Harinarayan, former Chief Secretary of Andhra Pradesh, has been appointed the new Chairman of the Insurance Regulatory and Development Authority (IRDA) by the Finance Ministry. He replaces C. S. Rao, whose five-year term ended May 14. Harinarayan, an Indian Administrative Services officer of the 1970 batch from the Andhra Pradesh cadre, has administrative experience serving in senior positions as Union Secretary to the Ministry of Water Resources and Principal Secretary, Irrigation in Andhra Pradesh. He will have a five-year tenure at IRDA and is joining at a time when many new global insurers have lined up to enter the Indian market in joint ventures with local firms. Harinarayan is seen as a regulator with a broad vision who can carry forward more reforms. The UPA government has been unable to push through legislative changes in the Insurance Act--specifically, raising the FDI cap in insurance--due to opposition from Left parties. Finance Minister Chidambaram has recently indicated that efforts to convince coalition partners to increase FDI in the sector will continue.

¶14. (U) Harinarayan told reporters that his mission is to widen and deepen insurance penetration in India, especially in the rural and health sectors, and encourage competition among insurers to give a better deal to consumers. Measured in terms of premium collections, the penetration is close to 4.1 percent of GDP in the life segment and 0.6 percent of GDP in the non-life segment. Harinarayan estimated that there is a case for lowering the premium on voluntary health-insurance policies that are renewed annually to make them more affordable to consumers. He also identified a need to ensure greater transparency in unit-linked insurance plans, savings

instruments that offer both life insurance and investment flexibility.

AIRLINE MARGINS HIT BY RISING FUEL PRICES

¶15. (U) Air traffic in India has grown tremendously in the last couple of years. This growth has been fueled largely by cheap fares pioneered by low-cost carriers. However, most airlines are losing money on their current operations. Most of the domestic operators in India are new entities and are yet to break even. While domestic capacity has increased sharply in the past year, mounting losses have forced the industry to reduce operating costs and rationalize

passenger fares. The need to add capacity while keeping losses in check has resulted in industry consolidation, by way of mergers and acquisitions. Low-cost carriers that already operate on wafer-thin margins are planning to cut down on flights to reduce losses.

¶16. (U) Aviation Turbine Fuel (ATF) now accounts for 35 to 40 percent of airlines' total operating costs. The unprecedented increase in fuel prices has compounded their losses. Indian domestic carriers pay a 66-percent tax on ATF, eight times higher than what international carriers pay. The higher rate of tax is eroding the profitability of Indian carriers by 11 to 16 percent.

¶17. (U) The recent decision of state-run oil firms to cut ATF prices by 4.3 percent provides little relief, as ATF prices have doubled over the last year. Indian carriers incurred losses of INR 40 billion during the last fiscal year; the industry's health does not permit it to lose any more. Airlines are expected to register a combined loss of INR 80 billion in 2008-09.

¶18. (U) Visit New Delhi's Classified Website:
http://www.state.sgov/p/sa/newdelhi

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